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No. 06-888

IN THE

Supreme Court of the United States

CORAL POWER, L.L.C., ET AL.,
Petitioners,

v.

PEOPLE OF THE STATE OF CALIFORNIA
EX REL. EDMUND BROWN, ATTORNEY GENERAL, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF ELECTRIC POWER SUPPLY ASSOCIATION, INDEPENDENT ENERGY PRODUCERS ASSOCIATION, AND WESTERN POWER TRADING FORUM AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF AMICI[1]

The Electric Power Supply Association ("EPSA") is a national trade association representing competitive electric power suppliers, including independent power producers, merchant generators, and power marketers. EPSA's members include companies that are involved in competitive electric markets, as well as various state and regional groups that represent the competitive power industry in their respective regions of the country. EPSA's members have significant financial investments in electric generation and electricity marketing operations in the United States. EPSA's organizational mission is the promotion of a favorable market environment for the competitive electric industry. EPSA supports the development of legislative and regulatory policies that encourage the development and implementation of a competitive market for electricity. EPSA also seeks to improve public awareness of the competitive electric industry. EPSA's members have a substantial interest in this case. Most of EPSA's members compete in the wholesale markets and those members will be directly impacted by the Ninth Circuit's decision in this case.

The Independent Energy Producers Association ("IEP") is a California non-profit mutual benefit corporation organized under the Non-Profit Mutual Benefit Corporation Law. IEP's specific purposes are to promote the social welfare by furthering the development and utilization of independent energy facilities to improve the ability of people to become more energy self-reliant, to further the national goal of reducing dependence upon imported sources of energy and to encourage supply options which benefit the society economically, socially, and environmentally. IEP

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[1] Letters of consent have been filed with the Clerk. Pursuant to Rule 37.6, *amici* state that no counsel for a party authored any part of this brief, and no person or entity other than *amici*, their members, and their counsel made a monetary contribution to the preparation or submission of this brief.

members collectively own and operate approximately one third of California's installed generating capacity. IEP members are commercially active in the western wholesale markets, generating and selling electricity products.

The Western Power Trading Forum ("WPTF") is a California non-profit, mutual benefit corporation. It is a broadly based membership organization dedicated to enhancing competition in Western electric markets in order to reduce the cost of electricity to consumers throughout the region while maintaining the current high level of system reliability. WPTF's actions are focused on supporting development of competitive electricity markets throughout the region and developing uniform operating rules to facilitate transactions among market participants. The membership of WPTF includes energy service providers, scheduling coordinators, generators, energy consultants and public utilities, all of which are active participants in the restructured California electricity markets.

INTRODUCTION

When Congress passed the Federal Power Act ("FPA") in 1935, the supply of the nation's electric power was controlled by a handful of holding companies that owned vertically integrated utilities with monopoly power in their respective markets. Because the wholesale energy markets were dominated by these monopolies, the Federal Power Commission (the predecessor to the Federal Energy Regulatory Commission (the "Commission" or "FERC")) could not rely on competitive forces to produce economically efficient outcomes, and was required to evaluate utilities' costs to determine whether their energy rates were "just and reasonable" as required under § 205(a) of the FPA, 16 U.S.C. § 824d(a). The marketplace for wholesale power has changed dramatically since then, particularly over the last 30 years. Now that many markets have become workably competitive, FERC has been able to eliminate many of the

inefficiencies associated with cost-based rate regulation and to rely principally on market forces to produce "just and reasonable" rates. This market-based approach has produced immense benefits for consumers and investors alike, and has advanced the purposes of the FPA by providing an adequate supply of power at reasonable prices, *viz.*, prices that accurately reflect supply and demand.

The Ninth Circuit's decision in this case threatens the continued viability of market-based regulation of this nation's wholesale power industry, to the substantial detriment of consumers, by eliminating the commercial certainty that is crucial to any functioning marketplace. The "well established 'filed rate' doctrine," which bars the Commission from altering a rate retroactively, "provid[es] th[at] necessary predictability." *Elec. Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985) (Scalia, J.). The Ninth Circuit cast that rule aside, declaring that market-based regulation is lawful only when, in retrospect, the Commission finds that sellers have complied to the letter with its technical "post-approval reporting" procedures *and* only insofar as the Commission uses "implied enforcement mechanisms" to provide "substitute remedies for the obtaining of refunds for the imposition of unjust, unreasonable and discriminatory rates." Pet. App. 11a, 15a–16a.

For all of the reasons explained in the petition for certiorari, this Court should review the Ninth Circuit's conclusion that FPA § 205 "implied[ly]" authorizes the Commission to order retroactive refunds of privately negotiated rates. That holding conflicts with the plain text of the statute and conflicts starkly with decisions of this Court and other courts of appeals. *Amici* file this brief, however, to emphasize the practical importance of the question presented. By effectively abrogating the filed rate doctrine in the context of market-based rate regulation, the Ninth Circuit has pulled the rug from existing market

participants who invested billions of dollars in reasonable reliance on lawful market-based rates. Unless the decision is reversed, moreover, it will gravely undermine confidence in the nation's wholesale electricity markets in the future. Some sellers will respond rationally by insisting on "risk premiums" to reflect the possibility—indeed, high likelihood—of collateral attacks on past transactions by parties with buyers' remorse. Some suppliers may forego market-based rates entirely in favor of antiquated and inefficient cost-based methods of rate regulation that at least will continue to provide a degree of certainty. And investors in the energy sector may simply choose to place their capital elsewhere. Any of these outcomes would profoundly harm consumers and the economy.

This economic disruption will not be confined to the circumstances of this case, where the Commission found that sellers failed to comply with technical post-approval reporting requirements for spot transactions. The Ninth Circuit has since made clear in a pair of decisions issued in December 2006 that in its view no market-based regime can satisfy the FPA absent the Commission's willingness to reach back and retroactively modify market-based rates—including rates negotiated by sellers that unequivocally have no market power. *See Pub. Utils. Dist. No. 1 of Snohomish County v. FERC* ("*PUD*"), 471 F.3d 1053, 1080-81 (9th Cir. 2006); *Pub. Utils. Comm'n of Cal. v. FERC* ("*CPUC*"), 474 F.3d 587 (9th Cir. 2006). *CPUC* and *PUD* build on the faulty analysis in this case and require the Commission to reconsider the justness and reasonableness of freely contracted prices negotiated pursuant to valid market-based rate authority as a prerequisite to protection from later regulatory interference.

By disregarding the fact that Congress encouraged private parties to negotiate rates by contract instead of filing broadly applicable tariffs, the Ninth Circuit's decision has eliminated the predictability that is essential to a

competitive energy marketplace. If not reversed, it threatens to erase billions of dollars in consumer welfare that would otherwise be generated by FERC's market-based regulatory system.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION INJECTS MASSIVE UNCERTAINTY INTO THE NATION'S WHOLESALE ENERGY MARKETS, AND WILL INFLICT ENORMOUS HARM ON CONSUMERS

Congress and the Commission have for decades strived to foster the appropriate conditions for competition in our country's wholesale energy markets. Congress has enacted numerous laws designed to "promote[] competition by lowering entry barriers and increasing transmission access," and "'to use the market rather than government regulation wherever possible both to advance energy security goals and to protect consumers.'" Electric Energy Market Competition Task Force, *Report to Congress on Competition in the Wholesale and Retail Markets for Electric Energy Pursuant to Section 1815 of the Energy Policy Act of 2005* at 2, 54 (2007) ("*Report on Competition*") (quoting H.R. Rep. No. 102-474(I), at 33 (1992)).[2] As the FERC Chairman recently observed, "competition in wholesale power markets is national policy," a policy re-embraced by Congress in the Energy Policy Act of 2005, "the third major federal law enacted in the last 25 years to embrace wholesale competition." FERC Chairman Joseph Kelliher, *Opening Remarks at the Competition in Wholesale Power Markets Conference*, FERC Docket No. AD07-7-000

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[2] *Available at* http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact-final-rpt.pdf. The Electric Energy Market Competition Task Force consists of representatives from the Department of Justice, FERC, the Federal Trade Commission, the Department of Energy, and the Rural Utilities Service. *Report on Competition* at 1 & n.3.

(Feb. 27, 2007); *see also 2006 Economic Report of the President* at 256 (Feb. 2006).[3]

Recognizing that "[m]arket-based rates help[] to develop competitive bulk power markets," the Commission authorizes parties to set rates based on prevailing market prices where it has concluded that market discipline will lead to just and reasonable rates. Final Rule, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540, 21,545 (May 10, 1996).[4] The Commission authorizes market-based rates, however, only upon a seller's demonstration that it "do[es] not have, or adequately ha[s] mitigated, market power in the generation and transmission of such energy, and cannot erect other barriers to entry by potential competitors." *La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998) (footnote omitted). As the D.C. Circuit has recognized, FERC's authorization of market-based rates in these circumstances is perfectly consistent with the FPA's mandate because "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable" within the meaning of FPA § 205. *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990).

A seller's application to obtain market-based rate authorization is subject to notice and comment, and aggrieved parties can seek judicial review. *See La. Energy*, 141 F.3d at 368-69 (competitor and customer may challenge FERC's grant of market-based rate authority). After they

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[3] *Available at* http://www.gpoaccess.gov/eop/2006/2006_erp.pdf.

[4] Various states, including California, Connecticut, Maine, New Hampshire and Rhode Island, have also sought to improve competition by requiring utilities to divest their generation to independent entities. *Report on Competition* at 42.

have been granted market-based rate authority, moreover, sellers must provide public notice of any changes to the characteristics on which the Commission relied in granting market-based rate authority, file quarterly reports summarizing the terms of their market-based transactions, and fully update their market power analyses every three years. *See, e.g., Reporting Requirement for Changes in Status For Public Utilities With Market-Based Rate Authority*, Order No. 652, 110 FERC ¶ 61,097 at 61,401 (2005).[5] The Commission actively monitors these filings; in response to a complaint challenge or acting *sua sponte* under § 206 of the FPA, it retains the ability to revoke a seller's blanket market-based rate authority.[6]

Congress's and FERC's initiatives to develop competitive markets have fundamentally changed and dramatically enhanced this nation's energy markets. In sharp contrast to the concentration and vertical integration that historically defined the industry, these reforms have encouraged non-traditional participants, including independent power producers and power marketers[7] to enter the marketplace. As of April 1, 2006, the Commission had granted market-based rate authority to approximately 1170 entities, including 390 independent power marketers, 180 independent power producers, and 30 financial institutions. *See Market-Based Rates for Wholesale Sales of*

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[5] All of the sellers involved in this litigation had to report their transactions every quarter and had to submit all relevant materials to support their market-based rate authorization every three years. *See Revised Public Utility Filing Requirements*, Order No. 2001, 67 Fed. Reg. 31,043, 31,054 (May 8, 2002); *Unicom Energy, Inc.*, 91 FERC ¶ 61,305 (2000); *S. Co. Servs., Inc.*, 91 FERC ¶ 61,259 (2000).

[6] FERC, for example, revoked the market-based rate authority of various Enron subsidiaries upon finding that they manipulated the market and failed to notify the Commission of increases in their market shares. *See, e.g., Enron Power Mktg., Inc. & Enron Energy Servs., Inc.*, 103 FERC ¶ 61,343 (2003); *El Paso Elec. Co.*, 108 FERC ¶ 61,071 (2004).

[7] The term "power marketers" generally refers to entities that buy and sell electricity in the wholesale markets but do not themselves own generating facilities.

Electric Energy, Capacity and Ancillary Services, Notice of Proposed Rulemaking, 71 Fed. Reg. 33,102, 33,119 n.128 (proposed June 7, 2006) (to be codified at 18 C.F.R. pt. 35). These new participants have significantly expanded the nation's energy infrastructure by investing heavily in transmission upgrades and generation facilities; in fact, "[b]etween 1996 and 2004, roughly 74 percent of electricity capacity additions were made by nonutility power producers." *Report on Competition* at 35. As of 2004, non-utilities owned approximately forty percent of the nation's electric generation capacity (as compared to only 8 percent in 1993) and accounted for approximately one-third of the electricity generated. *Id.* at 14. During 2004, over $240 billion in wholesale market sales were reported to FERC, one quarter of which were in the continental West (mostly within the Ninth Circuit's jurisdiction).[8]

In recent years, financial institutions such as investment banks and hedge funds have assumed a central role in competitive wholesale electricity markets. For instance, in 2004 alone, financial institutions acquired approximately five percent of the total generating capacity in the United States. *See* FERC, *2004 State of the Markets Report* at 12, 50 (June 2005).[9] And power marketers affiliated with financial institutions, such as Morgan Stanley, Goldman Sachs, and Merrill Lynch, accounted for over 10 percent of total wholesale market sales by the first quarter of 2005.[10]

The development of robust energy trading markets has increased competition and efficiency in the power industry. The burgeoning trade in wholesale energy as a commodity is

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[8] *See* Platts, *Power Market Rankings*, *summarized at* http://www.platts.com/Electric%20Power/Resources/News%20Features/powerrank/ (follow "NERC Regions" and "Transaction Values" hyperlinks) (free registration required) (based on transactions analyzed by Platts).

[9] *Available at* http://www.ksg.harvard.edu/hepg/Papers/FERC.State.of.the.Markets.Report.2004.pdf.

[10] *See* Platts, *Power Market Rankings*.

evidenced in that "more than half of all generated electricity is exchanged on the wholesale market before it is sold to consumers." *2004 Economic Report of the President* at 162 (Feb. 2004).[11] Nationally, on a typical day, thousands of wholesale electric sales transactions are entered into pursuant to market-based rate tariffs and individually negotiated contracts for sales. Now, large regions of the United States, including New England, New York, California, the Midwest, Texas, and the Mid-Atlantic, are served by centralized power exchanges where energy can be bought and sold in or close to real-time at prices reflecting prevailing market conditions. As the Commission has observed, these bulk power markets provide pricing transparency that "can increase the efficiency of the trading process for sellers and buyers and can give clear price signals indicating the best place and time to build new generation." *Report on Competition* at 4. They have also "increased capital available to market participants" and "improved the industry's ability to address credit issues, increased the ability of companies to buy and sell energy, and increased market liquidity." *2004 State of the Markets Report* at 64. Under traditional cost-based regulation, "competitive centralized markets could not exist," because short-term transactions were executed with little notice and could not happen "[w]ithout blanket approval to sell power at market-based rates." Energy Information Admin., Office of Coal, Nuclear, Electric and Alternate Fuels, DOE, *The Changing Structure of the Electric Power Industry 2000: An Update* at 63 (Oct. 2000) ("*DOE Report*").[12]

The development of fluid, competitive energy markets and the increased number and diversity of market participants have produced tremendous and very tangible benefits for consumers. Preeminent energy industry analysts estimate that between 1997 and 2005 consumers saved approximately $34 billion relative to the costs if

[11] *Available at* http://www.gpoaccess.gov/usbudget/fy05/pdf/2004_erp.pdf.
[12] *Available at* http://tonto.eia.doe.gov/FTPROOT/electricity/056200.pdf.

traditional cost-based regulation had continued.[13] These substantial cost savings are not surprising; the entry of independent power generators and marketers fostered by the Commission's market-based rate regulation "has led to highly efficient new capacity coming on line" and "market incentives can lead to highly efficient plant operations." FERC, Notice of Proposed Rulemaking, *Regional Transmission Organizations*, FERC Stats. & Regs. ¶ 32,541 at 33,719 (1999).

Commercial certainty is the bedrock of the interdependent web of purchases and sales that occur every hour of every day in real-life wholesale power markets. Based on contractual commitments from buyers, wholesale sellers of electric power make corresponding commitments to buy or generate power. This web of physical and financial commitments may involve building new generation, contracting to buy firm electric supplies from other sellers, contracting for generating fuel, contracting for transmission services, and hedging electricity costs through futures, options, or financial instruments (*e.g.*, derivatives or swaps). The ability of buyers and sellers to enter into these commitments depends entirely on parties' confidence that the deal they agreed to will be the deal going forward and will not be subject to retroactive change.

The Ninth Circuit's decision puts all of those interdependent commitments and efficiency gains at risk by subjecting market-based rate transactions to the potential

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[13] *See* Cambridge Energy Research Associates ("CERA"), *Beyond the Crossroads: The Future Direction of Power Industry Restructuring* (Sept. 30, 2005), *summarized at* http://cera.ecnext.com/coms2/summary_0236-681_ITM; CERA, *California Power Crisis Aftershock: The Potential Modification of Western Power Contracts* (Apr. 2007) ("*Power Crisis Aftershock*"), *available at* http://www2.cera.com/westernpowercontracts/; *see also 1999 Economic Report of the President* at 216 (Feb. 1999), *available at* http://www.gpoaccess.gov/usbudget/fy00/pdf/1999_erp.pdf ("In a $212 billion industry, even small efficiency gains from competition can have large benefits.").

exercise of retroactive ratemaking authority. Its holding fundamentally undermines the settled expectations of all market participants by departing radically from this Court's longstanding precedents, the decisions of other circuits, and the Commission's own appreciation of the limits of its remedial authority. This Court and every other court to consider the issue has agreed that "Congress withheld from the Commission power to grant reparations." *Montana-Dakota Utils. Co. v. Nw. Pub. Serv. Co.*, 341 U.S. 246, 254 (1951); *see also Pub. Utils. Comm'n of Cal. v. FERC*, 894 F.2d 1372, 1383 (D.C. Cir. 1990) ("The Act's limited provision for refunds reflects a congressional determination that parties in the industry need to be able to rely on the finality of approved rates, and that this interest outweighs the value of being able to correct for decisions that in hindsight may appear unsound.").

In other contexts, this Court has found that the filed rate doctrine bars retroactive modification of rates even if intentional wrongs would be left without redress. *See, e.g., AT&T Co. v. Cent. Office Tel., Inc.*, 524 U.S. 214, 222 (1998) ("[E]ven if a carrier intentionally misrepresents its rate and a customer relies on the misrepresentation, the carrier cannot be held to the promised rate if it conflicts with the published tariff."). It has long been understood that the filed rate applies regardless of "the culpability of the defendant's conduct or the possibility of inequitable results." *Marcus v. AT&T Corp.*, 138 F.3d 46, 58 (2d Cir. 1998).[14] The Ninth Circuit has rejected that understanding in the context of market-based rates and in doing so has undermined the competitive market for electric power and supporting capital markets.

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[14] *See also Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 132 n.12 (1990) ("[The] risk of intentional misconduct ... has always existed and has never been considered sufficient to justify a less stringent interpretation of" the filed rate doctrine.).

If not corrected by this Court, the Ninth Circuit's atextual reading of FPA § 205 to provide the Commission retroactive ratemaking authority for market-based rate transactions will discourage participation in these transactions and jeopardize the health and existence of regional power exchanges. As FERC has recognized, "[t]he certainty and stability which stems from contract performance and enforcement is essential to an orderly bulk power market. If the integrity of contracts is undermined, business would be transacted without legally enforceable assurances and we believe that the market, the industry and ultimately the consumer would suffer." *Pub. Serv. Co. of N.M.*, 43 FERC ¶ 61,469 at 62,153 (1988), *aff'd, San Diego Gas & Elec. Co. v. FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990).

Under the Ninth Circuit's holding, individual and institutional investors in the power industry will be unable reliably to quantify the risk that FERC will retroactively change the terms of market-based transactions. At a minimum, market-based sellers will have to offset this regulatory uncertainty by building a "significant risk premium" into every transaction, increasing the cost of power to consumers. *See, e.g., Notice of Proposed Policy Statement*, 100 FERC ¶ 61,145 at 61,545 (2002) (Brownell and Breathitt, Comm'rs, concurring). And power markets that no longer produce reliable price signals will misallocate resources and starve investment in much needed energy infrastructure.

Because of the Ninth Circuit's adoption of retroactive ratemaking for market-based rate transactions, market-based rate sellers will now be disadvantaged when compared with cost-based rate sellers who labor under burdensome and inefficient regulation but nevertheless remain assured that their transactions are immune from retroactive refunds. If the Ninth Circuit's decision is upheld, sellers may seek the regulatory certainty that cost-based regulation provides, even with all of the attendant

"procedural delays in achieving tariff approvals and changes" that are endemic to centralized economic planning. *Promoting Wholesale Competition*, 61 Fed. Reg. at 21,545.

The power industry is projected to require new capital investment of almost $900 billion over the next 15 years, which is more capital than the net plant value in place today; approximately $400 billion of this projected need will be for new power plants and environmental retrofits (excluding carbon dioxide control costs) for existing power plants.[15] Developers of power plants and other essential energy infrastructure have to compete for highly mobile capital with entities in other industries that face little or no risk of regulatory intervention. As observed in the *Report on Competition*, "[i]n competitive markets, project funding is based on anticipated market-based projections of costs, revenues and relevant risk factors. The ability to obtain funding is impacted by the degree to which these projections compare with projected risks and returns for other investment opportunities." *Report on Competition* at 78; *see also Gulf State Utils. Co. v. FPC*, 411 U.S. 747, 769 (1973) ("Utility financing normally is accomplished through competitive bidding participated in by a relatively small number of national investment firms which specialize in the purchase from issuers and the wholesaling of utility securities. The market is highly competitive and is particularly sensitive to uncertainties."). As highlighted recently by a preeminent energy industry analyst and advisor, "[s]hortage of capital and interest rates are not the problem. Uncertainty is the problem."[16] By undermining the commercial certainty of market-based rate transactions, the Ninth Circuit harms the development of markets because "[c]ompetitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty." *Pub. Utils.*

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[15] *CERA, Power Crisis Aftershock*, at Key Implications, 15–16.

[16] Lawrence Makovich, CERA, *CERA Forecasts $800 Billion in Power Capex over 15 Years*, Electric Power Daily, Feb. 16, 2007, at 10.

Comm'n of Cal. v. Sellers of Long Term Contracts to the Cal. Dep't of Water Res., 99 FERC ¶ 61,087 at 61,383 (2002).

The Ninth Circuit's decision unquestionably will invite complaints from buyers seeking to escape ongoing transactions as well as demands for retroactive remedies from transactions that have closed. The Ninth Circuit's decision obviously opens the door to retroactive challenges by every disgruntled buyer who purchased energy from a seller whose periodic transactional reports were not in the precise format the Commission required, even though the Commission itself believes that those filing deficiencies "do not invalidate market-based pricing tariffs as lawful filed rates." Pet. App. 74a.[17] But even where compliance is not an issue, the Ninth Circuit's decision encourages a flurry of litigation challenging market-based rate transactions. For example, the State of Illinois recently filed a complaint at FERC pursuant to FPA §§ 205, 206 and 222, alleging that the Ninth Circuit's decisions in this case and in *CPUC* and *PUD* require FERC, at the State's behest, to modify or abrogate billions of dollars in wholesale power contracts.[18]

And this is only the tip of the iceberg. The Ninth Circuit declared broadly that the FPA "cannot be construed to immunize those who overcharge and manipulate markets," Pet. App. 18a, and held that "the power to order retroactive refunds," at least for "egregious" behavior, is "inherent in FERC's authority to approve a market-based tariff in the first place." *Id.* at 15a. This latter holding will invite charges of market manipulation and dysfunction and demands for retroactive relief from every buyer who now or in the future comes to regret having purchased when

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[17] FERC also noted in its Order on Rehearing that there "appears to have been some legitimate confusion as to the Commission's expectations" about the reporting requirements because sellers had provided aggregate sales data "for years without having been challenged by any market participant." Pet. App. 78a.

[18] *Complaint by the People of the State of Illinois ex rel. Lisa Madigan*, FERC Docket No. EL07-47-000 (filed Mar. 15, 2007).

supplies are tight and prices relatively high and volatile—precisely when society most needs suppliers entering and transacting in the market.

Contrary to the Ninth Circuit's view, this is manifestly bad news for the American consumer. The Commission recognized in a separate proceeding involving transactions in the Pacific Northwest that "refunds would have a negative impact on the ... market" and "would cause a loss of confidence ..., have a chilling effect on trading, cause costs to consumers to increase as market participants demand additional risk premiums and additional security for their transactions, create a hesitancy to conduct business in times of scarcity, and discourage investment in needed infrastructure." *Puget Sound Energy, Inc. v. All Jurisdictional Sellers of Energy and/or Capacity at Wholesale into Electric Energy and/or Capacity Markets in the Pacific Northwest, Including Parties to the Western Systems Power Pool Agreement*, 103 FERC ¶ 61,348 at 62,368–69 (2003). The same is true here. The Ninth Circuit's holding gravely undermines the FPA's purpose "to encourage the orderly development of plentiful supplies of electricity and natural gas at reasonable prices." *NAACP v. FPC*, 425 U.S. 662, 669-70 (1976). The dramatically increased risk of regulatory intervention in market-based rate transactions resulting from the Ninth Circuit's decisions in this case and *PUD* and *CPUC* is likely to cost consumers tens of billions of dollars over the next few decades because of risk-adjusted increases in the capital costs of power suppliers.[19]

II. THE NINTH CIRCUIT'S FAULTY REASONING IN THIS CASE THREATENS FURTHER ECONOMIC INSTABILITY

Although the Ninth Circuit purported to uphold FERC's ability to adopt a market-based approach to rate regulation,

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[19] *See* CERA, *Power Crisis Aftershock* at 20–22.

it imposed conditions on FERC's exercise of its discretion that make market-based rate regulation unworkable. The Ninth Circuit arrived at this result by badly misconstruing this Court's decisions in *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990), and *MCI Telecommunications Corp. v. AT&T*, 512 U.S. 218 (1994), both of which involved an entirely different sort of regulatory scheme than the FPA and the Natural Gas Act ("NGA"). In *Maislin* and *MCI*, this Court held that adherence to the tariffing scheme is "'utterly central'" to the administration of common carrier obligations set forth in the Interstate Commerce Act ("ICA") and the Communications Act;[20] therefore, the Court rejected agency rules substituting a market-based approach for the requirement that entities adhere strictly to published tariff rates.

Unlike the ICA and the Communications Act, the FPA does not mandate a *common carrier*, tariff-based regulatory scheme. To the contrary, the FPA (like the NGA) implements a *contract carrier* form of rate regulation under which parties may negotiate rates with particular customers that may be dramatically different from one customer to the next, and those rates are protected from after-the-fact modification except in extraordinary circumstances of unequivocal public necessity. As this Court has long recognized, the ability of parties to negotiate rates by contract stands the FPA and the NGA "in marked contrast to the [ICA], which in effect precludes private rate agreements." *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 338 (1956). By "depart[ing] from the scheme of purely tariff-based regulation and acknowledg[ing] that contracts between commercial buyers

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[20] *See Maislin Indus.*, 497 U.S. at 134–35; *MCI Telecomms.*, 512 U.S. at 234 ("For better or worse, the Act establishes a rate-regulation, filed-tariff system for common-carrier communications and the Commission's desire 'to "increase competition" cannot provide [it] authority to alter the well-established statutory filed rate requirements.'") (quoting *Maislin Indus.*, 497 U.S. at 135) (alteration in original).

and sellers could be used in rate setting," Congress embraced the notion that parties could be expected to reach the "just and reasonable" rate as between themselves, without the same heavy-handed regulation imposed under common carrier statutes. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 479 (2002).

Because the Ninth Circuit mistook the FPA for a *common carrier* regulatory scheme, it held that FERC's market-based scheme would fail to comply with this Court's holdings in *Maislin* and *MCI* unless FERC coupled market-based regulation with "implied enforcement mechanisms" that enable the Commission to order retroactive refunds. The court reasoned that "the power to order retroactive refunds ... is inherent in FERC's authority to approve a market-based tariff in the first instance." Pet. App. 15a. Otherwise, "there is no filed tariff in place at all." *Id.* That analysis cannot be squared with the text of the FPA. Although the FPA delegates to FERC considerable latitude in deciding how to regulate rates for wholesale electricity, "Congress withheld from [FERC] power to grant reparations" for rates that have already gone into effect. *Montana-Dakota Utils.*, 341 U.S. at 254; *see* Br. for Pet'r at 19–22 (discussing rejected version of FPA that would have given FERC authority to make retroactive rate adjustments). To be sure, Congress provided limited exceptions in §§ 205(e) and 206(b) "in order to accommodate the realities of administrative delay," *E. Tenn. Natural Gas Co. v. FERC*, 863 F.2d 932, 942 (D.C. Cir. 1988), but those provisions cannot be read to support the Ninth Circuit's expansive holding that FERC retains "inherent" authority to disregard the filed rate doctrine. *See Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986) (abrogation of the filed rate doctrine "must come from Congress, rather than from this Court").

The Ninth Circuit's flawed analysis of the FPA's statutory scheme, and of § 205 in particular, will have

disastrous consequences extending far beyond the confines of this case. In fact, some of these consequences already came to fruition in *CPUC* and *PUD*, a pair of decisions the Ninth Circuit issued in December 2006.[21] Building on the faulty analytical foundation that it created in this case, the Ninth Circuit held that the FPA requires FERC to "implement[] and use[] an effective oversight mechanism *after* the market-based rate authorization is initially granted" and to modify any rates that the Commission concludes, in hindsight, are not "just and reasonable." *PUD*, 471 F.3d at 1081. In so holding, the Ninth Circuit effectively threw out another bedrock principle under the FPA—that freely contracted rates may not be disturbed unless required by the greater public interest.

In *CPUC* and *PUD*, several purchasers secured long-term contracts that protected them from the volatility in energy prices during the Western Energy Crisis. Those purchasers or related third parties later came to second-guess the providence of these bargains and asked the Commission to permit them to abrogate or modify these contracts under § 206 of the FPA. FERC rejected their claims, applying longstanding precedent of this Court that requires enforcement of contracts except in "circumstances of unequivocal public necessity." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968) (citing *Mobile*, 350 U.S. 332). But the Ninth Circuit vacated FERC's order based on its decision in this case and held that contracts entered pursuant to FERC's market-based approach are not entitled to the protection traditionally afforded to privately negotiated arrangements because FERC failed to provide sufficient regulatory oversight to ensure that the contracted rates were just and reasonable. *PUD*, 471 F.3d at 1082. As in this case, the Ninth Circuit accepted that FERC may

[21] Several parties intend to file petitions for certiorari in the *CPUC* and *PUD* cases, which currently are due May 3, 2007. Because they involve similar missteps by the Ninth Circuit, this Court may find it beneficial to consider those petitions together with this case.

take a market-based approach to evaluating the justness and reasonableness of rates, but it held that FERC must be able to consider "sudden market changes" and protect "purchasers victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight." *Id.* at 1085. It concluded that FERC abdicated its statutory responsibility by giving deference to voluntary private agreements and limiting its review of such contracts to public interest concerns. *Id.*

The regulatory review now required by the Ninth Circuit is untenable in a market environment. The competitive market cannot thrive under constant threat of *post hoc* challenges and retroactive refunds. Market participants must be able to rely on the commercial certainty of their market-based transactions after they have been lawfully entered pursuant to FERC's market-based regulatory framework, both with respect to spot-market transactions and long-term contracts. Subjecting market-based transactions to retroactive remedies destroys the contract certainty that this Court and FERC have recognized is essential to the functioning of markets generally, and to healthy energy markets in particular. *See infra* at 10–12; *see also Mobile*, 350 U.S. at 344 ("[T]he stability of supply arrangements ... is essential to the health of the natural gas industry."); *Report on Competition* at 76 ("[L]ong-term contracts [are] a critical prerequisite in obtaining financing for new generators" but the "ability to arrange long-term contracts is inhibited by ... the unpredictability of state and federal regulation."). And the Ninth Circuit's decisions nullify many of the efficiency gains produced under FERC's market-based regulations, because market participants will no longer be able to react quickly to market opportunities. Under the Ninth Circuit's decisions, there is simply nothing a seller can do to insulate its market-based transactions from the risk of future modification or

abrogation except to seek FERC's blessing of *every* transaction before it takes effect.[22]

Congress did not overlook the importance of contract stability in enacting the FPA; it built that tenet into the structure of the Act by deliberately withholding reparations as an available remedy for after-the-fact rate challenges. *See Montana-Dakota Utils. Co.*, 341 U.S. at 254. The Ninth Circuit acknowledged that the statute does not make retroactive remedies expressly available, but the court nevertheless concluded that they must be implied as "substitute remedies" to "create a 'symmetrical and coherent regulatory scheme.'" Pet. App. 16a (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)). Contrary to the Ninth Circuit's holding, while Congress delegated to FERC the broad authority to establish a regulatory framework that will protect consumer interests, it clearly withheld the power to order retroactive remedies. As a practical matter, the Ninth Circuit's decision impermissibly shackles FERC to antiquated cost-based regulatory methods that Congress did not require, and at the same time purports to give FERC remedial authority that Congress specifically prohibited.

CONCLUSION

For all these reasons, and those set forth by petitioner, the petition for certiorari should be granted.

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[22] In *CPUC*, the Ninth Circuit suggested that contracts may be subjected to plenary *post hoc* review even where a seller submits contracts for prior review. The Court held that a contract that had been filed with and accepted by the Commission was not necessarily entitled to *Mobile-Sierra* protection because the Commission's review could not have considered information that was unknown to any party (including the buyer and seller under the contract) at the time of filing. *CPUC*, 474 F.3d at 595 ("At the time Dynegy filed its contract, the full scale of spot market manipulation and forward market dysfunction was not nearly as fully known as it is today.").

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